

**SECTION 3806.—MITIGATION OF EFFECT OF RENEGOTIATION OF WAR CONTRACTS OR DISALLOWANCE OF REIMBURSEMENT**

Rev. Rul. 53

**INTERNAL REVENUE CODE**

Treatment for Federal income tax purposes of price adjustments made by contracting officers of the Government in pursuance of price redetermination clauses embodied in Government contracts and the allowance of credits against such price adjustments, under section 3806 of the Internal Revenue Code, of the Federal income taxes attributable to such price adjustments.

Advice is requested as to the position of the Bureau with respect to the treatment of refunds made to contracting officers of the Government in pursuance of a price redetermination clause embodied in a Government contract.

Section 508 of the Revenue Act of 1942 added section 3806 to the Internal Revenue Code. Section 3806 of the Code, as amended, provides for the mitigation of effect of renegotiation of war contracts or disallowance of reimbursement. Subsections (a)(1)(A) and (B) of this section were amended by section 203 of the Renegotiation Act of 1951 (Public Law 9, 82d Cong., C. B. 1951-1, 180) approved March 23, 1951, to read:

(A) The term "renegotiation" includes any transaction which is a renegotiation within the meaning of the Federal renegotiation act applicable to such transaction, any modification of one or more contracts with the United States or any agency thereof, and any agreement with the United States or any agency thereof in respect of one or more such contracts or subcontracts thereunder.

(B) The term "excessive profits" includes any amount which constitutes excessive profits within the meaning assigned to such term by the applicable Federal renegotiation act, any part of the contract price of a contract with the United States or any agency thereof, any part of the subcontract price of a subcontract under such a contract, and any profits derived from one or more such contracts or subcontracts.

Accordingly, any modification of one or more contracts with the United States or any agency thereof and any agreement with the United States or any agency thereof in respect of one or more such contracts or subcontracts thereunder is a "renegotiation" as that term is defined in section 3806(a)(1)(A) of the Internal Revenue Code, as amended; and any part of the contract price of such a contract or subcontract is "excessive profits" as that term is defined in section 3806(a)(1)(B) of the Internal Revenue Code, as amended.

Section 3806(a)(1) of the Internal Revenue Code, as amended, provides that a payment or repayment within a taxable year ending after December 31, 1941, of excessive profits pursuant to a renegotiation shall be treated as a reduction of the price of the contracts or subcontracts for the taxable year for which such price was received or accrued. Section 3806(b)(1) of the Code requires that there shall be credited against the amount of excessive profits eliminated through renegotiation the amount by which the Federal income tax for the prior taxable year is decreased by reason of the excessive profits eliminated. Subsection (c) of section 3806 of the Code provides that,

480  
if a credit is allowed under subsection (b) with respect to a prior taxable year, no other refund or credit under the internal revenue laws founded on the application of subsection (a) shall be made on account of the amount allowed with respect to such taxable year. If the amount allowable under subsection (b) exceeds the amount allowed under such subsection, the excess shall, for the purposes of the internal revenue laws relating to credit or refund of tax, be treated as an overpayment for the prior taxable year which was made at the time the payment, repayment, or offset was made.

Based on the foregoing, any refund made to the United States or any agency thereof in pursuance of a price redetermination clause in a Government contract is a renegotiation under the provisions of section 3806(a), and accordingly the taxpayer is entitled to a credit against the excessive profits of the amount of the decrease in Federal income taxes attributable to such excessive profits and is required to pay or repay to the United States only the amount of the excessive profits remaining after there has been credited against such excessive profits the amount of the Federal income taxes attributable thereto.

In case a repayment under a price redetermination clause is determined prior to the time the taxpayer files its income tax return, consideration should be given to I. T. 3611, C. B. 1943, 978. This ruling reads in part as follows:

In giving effect to the principles applied by section 3806 of the Code in case the renegotiation agreement determines reduced contract prices to be charged during the year of the agreement or subsequent thereto, or a repayment is to be made in lieu thereof which is not applicable to profits for a year for which an income tax return has been filed, and on which profits income and excess profits taxes have not been assessed or paid, the practice of the Bureau has been to permit the taxpayer to reduce the gross income to be reported in the returns for such years to conform with the reduced price or, in case of repayment, to permit a deduction to be taken in computing net income, provided, excessive profits determined to have been realized and received by the taxpayer are repaid to the Government. Likewise, in case the reduced contract prices are determined for the immediately preceding taxable year or a repayment is to be made in lieu thereof, and the completed income and excess profits tax returns for such year have not been filed at the time of such determination, the taxpayer has been permitted to report the gross income for such preceding year to conform with the reduced prices agreed upon or to take a deduction in computing net income, as the case may be, provided the taxpayer repays to the Government the excessive profits determined to have been realized. No deduction from gross income is allowed for any other taxable year for the amount of such excessive profits so repaid. This method of treatment will continue to be followed, subject to the condition that the excessive profits be paid or repaid to the United States or credited against amounts due and payable from the United States, and no deduction from gross income will be allowed for any other taxable year for the amount of such excessive profits so repaid. (See I. T. 3577, C. B. 1942-2, 163.)

Accordingly, it is held that where a taxpayer has entered into a price redetermination agreement with a contracting officer of the Government which provides for reduced contract prices to be charged for the immediately preceding taxable year for which a completed income tax return has not been filed and with respect to which profits

income and excess profits taxes have not been paid or assessed, the taxpayer will be permitted to take a deduction for such excessive profits in computing the net income in such return, provided the excessive profits determined to have been realized and received by the taxpayer are repaid to the Government. A taxpayer will not be entitled to set up and deduct a liability for excessive profits merely because it is performing a contract containing a price redetermination clause and there is a probability that excessive profits may be determined under such contract at a later date. In the case of any amounts repayable under a price redetermination clause which, however, are definitely determinable at the time the complete income and excess profits tax return for the year such profits were realized and received by the taxpayer is filed, the taxpayer will be permitted to reduce the contract prices to be reported in the return for such year or to take a deduction in computing the net income to be reported in such return by the amounts which can be definitely determined, provided such excessive profits are repaid to the Government. In case no amount of excessive profits has been determined or repaid prior to the time the income and excess profits tax returns for the year in which the contract prices were received or accrued were filed, it is considered that no basis exists at the time the returns are filed for determining the amount by which the contract prices should be reduced and that, for the purpose of reporting taxable income from the applicable Government contracts under sections 41, 42, and 43 of the Internal Revenue Code, the taxpayer is required to report in full the contract prices in the taxable year in which received or accrued, depending upon the method employed in keeping the books, unless, upon submission of all the facts and circumstances, permission is granted by the Commissioner for reporting income on a different basis. If, at a later date, the taxpayer is required to repay excessive profits in pursuance of a price redetermination clause embodied in a Government contract, adjustment should be made under section 3806 of the Code as the facts warrant.

---

**SECTION 3813.—REQUIREMENTS FOR EXEMPTION OF  
CERTAIN ORGANIZATIONS UNDER SECTION 101(6) AND  
FOR DEDUCTIBILITY OF CONTRIBUTIONS MADE TO  
SUCH ORGANIZATIONS**

**Section 29.3813-1: Denial of exemption to organizations engaged in prohibited transactions.**

**INTERNAL REVENUE CODE**

Exemption status of trust where employees of donor corporation derive benefits from organizations to which trust contributions are made. (See Rev. Rul. 96, page 264.)